

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

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In the Matter of )  
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Price Cap Performance Review )  
for Local Exchange Carriers; )  
Treatment of Video Dialtone )  
Services Under Price Cap )  
Regulation )

CC Docket No. 94-1

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REPLY

This proceeding ought to be governed by the overarching principles that the Commission has followed in establishing its price cap rules.<sup>1</sup> Since the Commission first began examining price regulation as an alternative to traditional rate of return regulation, it has acknowledged that any limitations it embodies in the plan such as baskets or bands act as a counterweight to the efficiency and economic incentives that a price cap plan is intended to create. As the Commission has recognized, under a pure price cap plan, "all services offered by a carrier would be subject to a single price cap, and carriers would have unlimited ability

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<sup>1</sup> These Reply Comments only address issues assuming the Commission proceeds in bringing video dialtone services under price cap rules. As BellSouth pointed out in its Comments, video dialtone services are competitive and accordingly should be afforded streamline regulatory treatment.

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to migrate individual prices up or down so long as aggregate prices remained below the cap."<sup>2</sup>

Baskets and pricing bands limit pricing flexibility and thereby diminish the potential for economic efficiency gains. Accordingly, their inclusion in the LEC price cap plan are only justified by competing policy concerns that must be specifically addressed.

Unlike Part 69 of the Commission's rules, the LEC price cap rules are capable of handling the introduction of video dialtone ("VDT") services without modification. The capability of accommodating new services was specifically incorporated into the LEC price cap plan. Moreover, it was contemplated that all new services would come under the price cap except for a service falling within a specific and limited category of services, e.g., ICBs, special construction. The offering of VDT services, in and of itself, does not trigger the type of inquiry being conducted here.

Because the price cap rules already provide a mechanism for handling the introduction of VDT service, the issue before the Commission is to identify a compelling public interest policy that necessitates modification of the price cap rules. The burden here is not to justify the existing

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<sup>2</sup> Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, para. 198 (1990), ("LEC Price Cap Order").

price cap plan, but rather to demonstrate that a modification of the rules is necessary.

The requisite demonstration has not been made. Instead, hypothetical concerns with little probability of occurring are advanced as sufficient to warrant imposing further limitations on the LEC price cap rules and thereby reducing the rules' efficiency incentives. Hypothetical concerns, however, can hardly be considered sufficient to meet the compelling public interest standard that might justify the efficiency sacrificed.

A. A Separate Price Cap Basket Should Not Be Established For VDT Service

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No party has demonstrated any basis for treating VDT service differently from any other new service. The arguments used to advocate the creation of a separate VDT price cap basket are devoid of factual or analytical support.

Numerous parties pick-up the cross-subsidy theme presented in the Notice as justification for a separate price cap basket for VDT services.<sup>3</sup> Other than echoing the

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<sup>3</sup> See e.g., MCI Telecommunications Corporation ("MCI"), California Cable Television Association ("CCTA"), Ad Hoc Telecommunications Users Committee ("Ad Hoc") and AT&T.

Notice,<sup>4</sup> these parties present nothing to support the view that cross-subsidy would occur.

Indeed, under the realities of the current marketplace coupled with the operation of the Commission's current price cap rules, cross-subsidy contentions cannot withstand scrutiny. The concern expressed in the Comments can be summarized as follows: unless VDT services are placed in a separate price cap basket, BellSouth and other LECs will be able to offset price decreases for VDT services with price increases for other services.

This proposition, however, is fallacious. In the first instance, the LEC price cap rules already provide for multiple baskets. Because VDT services would fall within the trunking basket, VDT services could not be subsidized by services in the traffic sensitive, common line or interexchange baskets.

The only potential for cross-subsidy, then, would come from transport services included within the trunking basket. The likelihood of some form of cross-subsidy occurring defies measurement. It simply is not a real possibility. All of the transport services currently included in the trunking basket face competition. Not only are there alternative sources of supply available for these services

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<sup>4</sup> In the Matter of Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, CC Docket No. 94-1, Further Notice of Proposed Rulemaking, released February 15, 1995, ("Notice").

but also the competitiveness of these services have been enhanced by the availability of expanded interconnection.

In order for BellSouth to cross-subsidize VDT services in the manner commenters portray, it would have to be able to raise prices in its major metropolitan area markets because it is in such market areas where the demand for services are greatest. Yet, these are the areas where competitive access suppliers are aggressively building out their own networks in competition with BellSouth. Simply put, the competitive market place will not permit BellSouth to raise the prices of its other transport services.

In addition to market pressures, regulations already exist that are a further check on any potential for cross-subsidy. Current transport services are grouped into several service bands, each of which is bounded by an upper pricing limit of 5 percent. Thus, if VDT services were included in the trunking basket, lowering the prices of VDT services, while lowering the API of the basket, would not affect the upper pricing limit of the existing service bands. In other words, BellSouth could not raise the prices of its other transport services any more than they already can.

The inescapable conclusion is that under current rules and marketplace conditions, BellSouth does not have the ability to raise prices of its transport services in order

to cross-subsidize VDT services. The potential for cross-subsidy simply does not exist.

Some parties contend that a separate basket for VDT services is necessary because VDT uses new technologies.<sup>5</sup> That contention is a lame excuse for establishing a separate price cap basket. The price cap rules were not drawn around a fixed set of technologies. To suggest that a separate basket is necessary because a new technology is involved implies that the price cap rules as constituted cannot accommodate technological change--that they are grounded upon technological stagnation. Such a conclusion, however, would be directly contrary to a purpose of price cap regulation, which is to create incentives that would induce LECs to be innovative and introduce new technologies.

More importantly, new technologies used to provide transport services have been introduced without the need to modify the price cap rules. Thus, fiber facilities, ring topologies and synchronous optical network based services have been accommodated under existing rules. VDT services do not represent such a radical departure from this trend so as to warrant a unique treatment under price caps.

Indeed, the fundamental network components for VDT services are no different than the network components currently being used to provide other services. In fact the cries of some commenters that the Commission must prescribe

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<sup>5</sup> See e.g. GTE Service Corp. ("GTE") at 13-15.

a methodology to allocate common costs belie the claim that VDT services are technologically unique and reinforce BellSouth's position that technology is an insufficient basis for establishing a separate price cap basket.

Finally, some commenters acquiesce to a separate VDT basket on the theory that such a basket would ease the ultimate removal of VDT services from price cap regulation.<sup>6</sup> A separate basket is not a prerequisite for removing a service from price caps. Indeed, the Commission has followed a service-by-service approach in removing AT&T's services from price regulation, not a basket-by-basket approach. If VDT services were ultimately excluded from price regulation, there would be no extraordinary difficulty in adjusting the price indices of the trunking basket accordingly.

No commenter has been able to demonstrate a compelling public policy interest that can only be protected through the establishment of a separate VDT service basket. Thus, the price cap goal of maximizing economic efficiency must prevail and a separate VDT price cap basket should not be established.

**B. VDT Should Be Included In The Interstate Rate of Return For Purposes Of The Sharing And Low End Adjustment Mechanisms**

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Several commenters argue that costs and revenues of VDT services should be excluded from the calculation of an

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<sup>6</sup> See NYNEX at 4.

interstate rate of return that is used for purposes of the sharing or low end adjustment mechanisms.<sup>7</sup> These parties overlook the fact that the sharing and low end adjustment mechanisms are vestiges of rate of return regulation. They are grounded in rate of return/rate base regulation. The price cap rules do not determine the rate base or the manner in which the interstate rate of return is calculated. This proceeding cannot be used to modify rules governing those matters.

Equally important is the fact that there is nothing in this record that would justify apportioning productivity and earnings responsibility among different services or price cap baskets. The commenters that urge excluding the costs and revenues from sharing or low end adjustments imply that such a result would be more precise. It is not difficult to penetrate past the rhetoric to the reality that all that is being advocated is the enactment of arbitrary cost allocation rules. Such an approach runs counter to the objectives of the price cap rules that were designed to move away from detailed cost allocations.

More importantly, if the Commission is going to include VDT under its price cap rules, then the sharing obligation must be determined by including all of VDTs revenues and costs. Otherwise, the Commission can exclude VDT from price caps. The Commission cannot, however, "pick and choose" by

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<sup>7</sup> AT&T at 6-7, Ad Hoc at 19-20.

including VDT under price caps for price regulation purposes but exclude it from the sharing calculation.

C. Conclusion

While most commenters either urge or are willing to acquiesce in the creation of a separate price cap basket for VDT services, none have been able to demonstrate that the public interest compels such an outcome. At best, all these commenters do is echo the rationale set forth in the Notice. More is required if the Commission is going to further reduce the economic efficiency incentives of the LEC price cap plan by establishing yet another price cap basket. BellSouth's concern from the beginning of this proceeding has been that the Commission has embarked on a path that will modify the LEC price cap plan by increasing regulatory constraints and reducing economic efficiency. That type of result creates a powerful disincentive for LECs to invest in VDT.

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**CERTIFICATE OF SERVICE**

I hereby certify that I have this 17th day of May, 1995 served all parties to this action with a copy of the foregoing REPLY by placing a true and correct copy of the same in the United States Mail, postage prepaid, addressed to the parties listed on the attached service list.

  
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